

***United States Court of Appeals  
for the Second Circuit***



**BRIEF FOR  
APPELLEE**





# 76 5007

UNITED STATES COURT OF APPEALS  
FOR THE SECOND CIRCUIT

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P/S

In re

FIDELITY MORTGAGE INVESTORS,

Debtor,

FIDELITY MORTGAGE INVESTORS,

Applicant-Appellee,

-against-

CAMELIA BUILDERS, INC., E. J.  
YELVERTON, JR., FARNALE, INC.,  
R. L. GOODALE and JEFFREY H.  
HUBBARD,

Respondents-Appellants.

APPEAL FROM THE UNITED STATES  
DISTRICT COURT FOR THE SOUTHERN DISTRICT  
OF NEW YORK

BRIEF OF APPELLEE FIDELITY MORTGAGE INVESTORS

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Of Counsel.





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### Statement of Issues

The issues presented on this appeal are (1) whether a knowing and wilful violation of Chapter XI Rule 11-44 constitutes contempt; (2) whether Respondents had knowledge of the Fidelity Mortgage Investors Chapter XI case and the automatic stay provisions of Chapter XI Rule 11-44; and (3) whether Respondents correctly relied on 28 U.S.C. §959 in commencing and continuing an action against Fidelity Mortgage Investors, debtor-in-possession.



### Statement of the Case

Fidelity Mortgage Investors ("FMI"), as debtor-in-possession, appellee herein, applied to the bankruptcy court on March 28, 1975, for an order (1) adjudging Camelia Builders, Inc., E. J. Yelverton, Jr., Farnale, Inc., R. L. Goodale and Jeffrey H. Hubbard (hereinafter collectively referred to as "Respondents") in civil contempt or, in the alternative, certifying the facts of Respondents' contumacious conduct to the district court; (2) temporarily restraining Respondents from proceeding with an action against FMI in the United States District Court for the Southern District of Mississippi (the "Mississippi Action"); (3) requiring Respondents, jointly and severally, to reimburse FMI for its actual costs, expenses, disbursements and attorneys' fees necessarily incurred in defending the Mississippi Action and in obtaining the relief it sought in the bankruptcy court; and (4) granting FMI such other and further relief as was just. (App.\* at 102-106.)

A hearing on FMI's application was held in the bankruptcy court on April 10 and 11, 1975. On July 14, 1975, based upon the testimony adduced and the other evidence, the

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\* "App." refers to the appendix on this appeal.



bankruptcy judge held that Respondents' commencement of the Mississippi Action constituted contempt. (App. at 100.) Because he found Respondents' contempt to be "grave," the bankruptcy judge also held that the authorized punishment under Rule 920(a)(3) of the Rules of Bankruptcy Procedure was insufficient. (App. at 91.) Accordingly, on July 29, 1975, pursuant to Section 41 of the Bankruptcy Act, 11 U.S.C. §69, and Bankruptcy Rule 920(a)(4), the bankruptcy judge certified to the district court the facts adduced at the hearing before him on April 10-11, 1975, and, on the basis of the certified facts (the "Certificate"), directed Respondents to show cause in the district court why they should not be adjudged guilty of civil contempt. (App. at 8-13.)

On August 19, 1975, the parties presented their arguments in the district court, based on the evidence adduced in the bankruptcy court. Neither Respondents nor FMI offered any additional testimonial evidence.

On December 16, 1975, the district court rendered an opinion adjudging Respondents "guilty of contempt of court" and requiring them to pay to FMI the costs, including attorneys' fees, which it incurred in the Mississippi Action and in the prosecution of the contempt proceeding. The court further required Respondents to effect the return of certain



monies which FMI had deposited with the court clerk in the Mississippi Action. (App. at 23.) An order incorporating the relief granted by the district court was entered on January 15, 1976.

On January 27, 1976, Respondents filed their notice of appeal with the district court.

Respondents' commencement and continuation of the Mississippi Action in contravention of Chapter XI Rule 11-44 constituted the conduct which was the basis of the contempt proceeding. (App. at 102-103.) Respondents commenced the Mississippi Action on March 25, 1975 (App. at 107-113), subsequent to the commencement of the FMI Chapter XI case,\* without complying with the applicable Rules of Bankruptcy Procedure, but with actual knowledge of the pending Chapter XI case and the automatic stay provisions of Rule 11-44. Notwithstanding such knowledge, Respondents wilfully and deliberately violated the stay provisions by proceeding with the Mississippi Action, thereby depriving FMI and its estate of \$75,964.33 which FMI was required to deposit into court, and causing FMI to incur legal fees and related expenses.

The material facts in the case at bar are set forth in the Certificate. (App. at 8-13.)

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\* FMI filed its Chapter XI petition on January 30, 1975.



I

A KNOWING AND WILFUL VIOLATION  
OF CHAPTER XI RULE 11-44  
CONSTITUTES CONTEMPT

A. The Automatic Stay of Suits in Rule 11-44 is Clear  
and Specific.

Upon FMI's filing of its petition pursuant to Chapter XI Rule 11-6, the stay of actions against the debtor and stay of lien enforcement contained in Chapter XI Rule 11-44 immediately became effective. Rule 11-44 provides, in pertinent part, as follows:

(a) Stay of Actions and Lien Enforcement. A petition filed under Rule 11-6 or 11-7 shall operate as a stay of the commencement or the continuation of any court or other proceeding against the debtor, or the enforcement of any judgment against him, of any act or the commencement or continuation of any court proceeding to enforce any lien against his property, or of any court proceeding, except a case pending under Chapter X of the Act, for the purpose of the rehabilitation of the debtor or the liquidation of his estate.

The language of Rule 11-44(a) is clear and unequivocal. Thus, Respondents' commencement of the Mississippi Action against FMI with full knowledge of the pendency of the Chapter XI case was a direct violation of the provisions of Chapter XI Rule 11-44 and constituted contempt of an order of the bankruptcy court,\* punishable under Bankruptcy Rule

\* The bankruptcy court entered an order on February 28, 1975, which, among other things, fixed a date for the first meeting of creditors and noted that the Rule 11-44 automatic stay of suits was effective on January 30, 1975, the date on which FMI filed its Chapter XI petition. Accordingly, Respondents' attempt to distinguish the Bankruptcy Rules from a court order (Respondents' Brief at 7) is without merit.



920, made applicable to Chapter XI cases by Chapter XI Rule 11-63. Rule 920(a) provides, in pertinent part, as follows:

(2) Disposition by Referee upon Notice and Hearing. Any other conduct prohibited by §41a of the Act may be punished by the referee only after hearing on notice. The notice shall be in writing and shall state the time and place of hearing, allowing a reasonable time for the preparation of the defense, and shall state the essential facts constituting the contempt charged and whether the contempt is criminal or civil or both. The notice may be given on the referee's own initiative or on motion by a party, by the United States attorney, or by an attorney appointed by the referee for that purpose. If the contempt charged involves disrespect to or criticism of the referee, he is disqualified from presiding at the hearing except with the consent of the person charged.

(3) Limits on Punishment by Referee. A referee shall not order imprisonment nor impose a fine of more than \$250 as punishment for any contempt, civil or criminal.

(4) Certification to District Judge. If it appears that conduct prohibited by § 41a of the Act may warrant punishment by imprisonment or by a fine of more than \$250, he may certify the facts to the district judge. On such certification the judge shall proceed as for a contempt not committed in his presence.

Section 41 of the Bankruptcy Act, 11 U.S.C. §69, provides, in part, as follows:

(a) A person shall not, in proceedings before a referee, (1) disobey or resist any lawful order, process or writ.

The courts have consistently enforced the contempt provisions of Section 41a(1). See, Mueller v. Nugent, 184 U.S. 1 (1902); In re Rubin, 378 F.2d 104



(3d Cir. 1967); Docteroff v. New York Credit Men's Adjustment Bureau, 187 F.2d 4 (2d Cir. 1951); In re American Associated Systems, Inc., 373 F.Supp. 977 (E.D. Ky. 1974); In re Lawrence Carpet Co., 122 F.Supp. 912 (S.D.N.Y. 1954); In re Sussman, 85 F.Supp. 570 (S.D.N.Y. 1949); 1 Collier, Bankruptcy ¶¶2.57, 2.58 at 302.4-321 (14th rev. ed. 1974); 2A Collier, Bankruptcy ¶¶41.01, 41.03 at 1583, 1589 (14th rev. ed. 1974); see also, United States v. Ross, 243 F.Supp. 496, 499 (S.D.N.Y. 1965) ("A 'civil contempt' is a litigant's failure to do something ordered to be done in a civil action for the benefit of the opposing party therein.") In order to cite a party for contempt it must be established that (a) the alleged contemnor had knowledge of the order which he is said to have violated, (b) the order was specific and definite and (c) the conduct violated the order. In re Rubin, 378 F.2d 104, 108 (3d Cir. 1967). The bankruptcy judge determined, after a full evidentiary hearing, that Respondents in this case had knowledge of the stay of suits (App. at 12) and that the stay was specific.

The district court similarly concluded: "Mr. Hubbard was aware of the automatic stay provision of Rule 11-44 and yet he chose to proceed...." (App. at 23.) Indeed, the findings of the bankruptcy and district courts are confirmed by Respondent Hubbard's admissions in the



bankruptcy court that he was familiar with and understood Rule 11-44. (App. at 82,78.)

B. Asserted Good Faith Does Not Excuse Disobedience of the Automatic Stay of Rule 11-44.

Respondents rely on 28 U.S.C. §959(a) as a purported exception to Rule 11-44. (See IV, infra.) The courts below found, however, such reliance to be "misplaced." (App. at 22; see also App. at 93-98.) The courts below also held "Respondents' alleged good faith reliance on §959 will not prevent them from being held in contempt." (App. at 22; see also App. at 99.)

In In re American Associated Systems, Inc., 373 F.Supp. 977 (E.D. Ky. 1974), a case with factual and legal issues similar to those here, the contemnors commenced an action in state court against the trustee in bankruptcy and the bankruptcy judge in connection with certain plenary litigation that had previously been commenced by the trustee. Prior to the commencement of the contemnors' suit, the bankruptcy court entered an order directing that "all creditors ... hereby are ... enjoined and stayed from commencing or continuing any action at law or suit or proceeding in equity against said Debtor or said trustee in any court...." 373 F.Supp. at 977-78. The contemnors conceded that they had commenced their action with full knowledge of the stay order but, like Respondents here, erroneously



relied on 28 U.S.C. §959, arguing that the stay did not prohibit them from commencing the action. In finding contempt, the court held that 28 U.S.C. §959 was inapplicable, and that, accordingly, the "commencement of [the] state court actions against the trustee was a direct violation of the ... [stay] order." 373 F.Supp. at 979.

The court in the American Associated Systems case recognized that the respondents' conduct may have been in good faith, but that their actions still constituted contempt of court, reasoning as follows:

It is equally apparent that the deliberate disobedience by respondents ... is not mitigated by their subjective legal conclusions. Unlike its criminal counterpart, civil contempt is "'wholly remedial', serves only the purpose of a party litigant, and is intended to coerce compliance with an order of the court or to compensate for losses or damages caused by non-compliance." [Citations omitted.] [T]he good faith underlying the respondents' determination to sue in the Kentucky court does not diminish their culpability. [373 F.Supp. at 979.]

Thus, the intentions of the Respondents in doing the prohibited act are of no consequence if the act is in contravention of the court's order. See, In re American Associated Systems, Inc., supra, 373 F.Supp. at 979; see also, McComb v. Jacksonville Paper Co., 336 U.S. 187, 191 (1949); NLRB v. Local 282, 428 F.2d 994, 1000-1001 (2d Cir. 1970) ("... a violation need not be wilful for a party to be found



in civil contempt."); NLRB v. Ralph Printing & Lithographing Co., 433 F.2d 1058, 1062 (8th Cir. 1970), cert. den., 401 U.S. 925 (1971); United States v. Ross, 243 F.Supp. 496, 499 (S.D.N.Y. 1965) ("In civil contempt proceedings the question is not one of intent but whether the alleged contemnors have complied with the court's order.") Furthermore, even where the contemnor purportedly acted in good faith and on the advice of counsel, he may be found in contempt where the contemptuous conduct is a "deliberate violation of a plain and specific order of the court." 1 Collier, Bankruptcy ¶2.58 at 315 (14th rev. ed. 1974).

The record in the bankruptcy court unequivocally demonstrates that when Respondents commenced the Mississippi Action they were fully aware of the FMI Chapter XI case and the specific stay provisions of Rule 11-44 (see III, infra). Nevertheless, Respondents deliberately commenced and prosecuted the Mississippi Action. If Respondents believed themselves unduly prejudiced by the Rule 11-44 stay, adequate relief was available under that rule in the bankruptcy court.\* (See IV, infra.) Instead, as Respondent Hubbard testified in the bankruptcy court, he tried "to hedge the bet" that the commencement of the Mississippi Action did not violate Rule 11-44. (App. at 77.)

\* In fact, Respondents belatedly sought a modification of the stay of suits from the bankruptcy court on May 27, 1975.



The bankruptcy court characterized Respondents' action as a wilful and deliberate violation of the stay provisions of Rule 11-44 "or, at the very least, treatment of] the Rule so cavalierly as to constitute a complete disregard for the consequences ...." (App. at 92.) Such conduct manifests a complete disregard for the jurisdiction of the bankruptcy court. Indeed, the district court concurred with the bankruptcy court's conclusion that Respondent's conduct "only indicates ... a contemptuous attitude to Rules which have the sanction of the Supreme Court and of the Congress of the United States." (App. at 23.)

C. A Violation of Rule 11-44 is Equivalent to a Violation of an Order of the Court.

Respondents cite no authority for their assertion that a violation of a Bankruptcy Rule (Rule 11-44) is not punishable by contempt. In fact, the courts have held that a violation of the injunctive provisions of the Rules of Bankruptcy Procedure, specifically Rules 401 and 601, does constitute contempt, subjecting the contemnor to punishment under Bankruptcy Rule 920. See, In re Tallyn, 2 Bank. L. Rep. ¶65,617 (E.D. Va. 1975); In re Robert Stephen Young, 1 Collier Bankruptcy Cases 145 (M.D. Fla. 1974). Bankruptcy Rules 401 and 601 are plainly the equivalent of Chapter XI Rule 11-44. Thus, Respondents' violation of the injunctive



provisions of Rule 11-44 should and does subject them to punishment for their contempt.

Furthermore, Rule 11-44 makes automatic that which was previously\* achievable by order under Section 314 of the Bankruptcy Act. See, Murphy, Restraint and Reimbursement: The Secured Creditor in Reorganization and Arrangement Proceedings, 30 Bus. Law. 15, 42 (1974). Surely the creation of the rule was not meant to deprive the court of the method of enforcing the stay, i.e., its contempt powers under Section 41a(1) and Rule 920.

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\* The Chapter XI Rules became effective on July 1, 1974.



## II

### THE FINDINGS OF FACT ARE CONCLUSIVE UNLESS CLEARLY ERRONEOUS.

As Respondents concede in Point III of their "Motion to Vacate Order to Show Cause,"\* "a full and complete hearing was had..." in the bankruptcy court on April 10-11, 1975, in accordance with Bankruptcy Rule 920(a)(2).

In his decision of July 29, 1975, the bankruptcy judge found that the punishment available to him under Bankruptcy Rule 920(a)(3) was insufficient, in view of Respondents' conduct. (App. at 90-01, 100.) Pursuant to Bankruptcy Rule 920(a)(4) (see page 5, supra), the bankruptcy judge certified his findings of fact to the district court which held that such facts constituted contempt and fixed an appropriate measure of punishment.

Bankruptcy Rule 810 provides that on appeals to the district court, "the court shall accept the referee's findings of fact unless they are clearly erroneous, and shall give due regard to the opportunity of the referee to judge the credibility of the witnesses." Logically, Rule 810 also should apply to a bankruptcy judge's certification of facts to the district court. Bankruptcy Rule 752(a), also dealing with findings of fact, has the same effect:

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\* Document No. 4 in the Index to the Record on Appeal.



"Findings of fact shall not be set aside unless clearly erroneous ...."

In In re Roark, 28 F.Supp. 515, 518 (E.D. Ky. 1939), the court stated the general rule which is still applicable under the Rules of Bankruptcy Procedure:

As to the ruling of the referee requiring the bankrupt and his wife to make restitution to the estate to the extent of \$500, the applicable rule is that the court should not disturb the findings of the referee upon disputed issues of fact, "unless there is most cogent evidence of mistake and miscarriage of justice." Kowalsky v. American Employers Inc. Co. (C.C.A., 6th Cir.), 34 Am.B.R. (N.S.) 280, 90 F.(2d) 476. Realizing that the referee, having heard the witnesses in person, is in a much better position than the court to determine the credibility of witnesses and the truth as to disputed facts, I am unable to say that the action of the referee in this respect is clearly erroneous, and hence the petition for review is denied and the referee's order approved and confirmed in this respect.

Similarly, in Mazer v. United States, 298 F.2d 579, 581-582 (7th Cir. 1962), the court said:

Initially appellant contends that the evidence does not support the findings of fact. The standard by which the referee's findings of fact are to be judged is whether they are clearly erroneous. [Citations omitted.]

Like Mazer, supra, Allen v. Lokey, 307 F.2d 353 (5th Cir. 1962), is based on former General Order in Bankruptcy No. 47, from which Rule 810 is derived. Accordingly, the Fifth Circuit held that it was unable to "set aside the referee's findings if they are not 'clearly erroneous.'" 307 F.2d at 354.



As hereinafter demonstrated (see III, infra), the bankruptcy judge's Certificate was based upon the undisputed evidence and on Respondents' own testimony. Thus, the district court properly concluded that Bankruptcy Rule 810 is applicable, that the findings of fact were not clearly erroneous, and that Respondents were guilty of civil contempt. (App. at 21.)

The district court correctly distinguished O'Hagen v. Blythe, 354 F.2d 83 (2d Cir. 1965), on which Respondents erroneously rely. (Respondents' Brief, at 13.) (App. at 20-21.) O'Hagen, which involved a criminal, rather than a civil contempt citation, is not applicable because it was decided prior to October 1, 1973, the effective date of the Bankruptcy Rules. Moreover, the O'Hagen decision was based on the premise that the bankruptcy court had no power to adjudge and punish anyone for contempt, a premise which has been superseded by Bankruptcy Rule 920. According to the court in O'Hagen,

There is, of course, the general principle of bankruptcy law that

"\* \* \* the report of a referee  
\* \* \* shall set forth his findings of fact and conclusions of law, and the judge shall accept his findings of fact unless clearly erroneous. \* \* "  
[Citations omitted.]

Punishment for contempt, following a certificate by a Referee, does not how-



ever, come within this rule. The Referee has no power to punish for contempt. [Citations omitted.] [354 F.2d at 84.]

Under Bankruptcy Rule 920, however, the bankruptcy judge is now empowered to adjudge and punish civil contempt. Here, the bankruptcy judge merely found that Respondents were guilty of contempt. (App. at 100.) The O'Hagen case, therefore, is not applicable.

The court in O'Hagen was not bound by the bankruptcy court's findings, moreover, because the referee there had failed to make a factual determination as to one material element for the finding of contempt. 354 F.2d at 84-85. Respondents make no such argument here, for they cannot. In fact, the bankruptcy judge allowed Respondents to introduce immaterial testimony and evidence at the hearing in April of 1975 in order to give them every opportunity to demonstrate that their conduct was not contemptuous. (App. at 40, 42.) Consequently, this court is bound under Bankruptcy Rules 752(a) and 810 to accept the bankruptcy court's findings of fact.



### III

THE FINDINGS OF FACT BY  
THE BANKRUPTCY COURT ARE  
NOT CLEARLY ERRONEOUS

The courts below had to determine only two factual issues: (a) whether Respondents had knowledge of FMI's Chapter XI case prior to commencing or while continuing the Mississippi Action, and (b) whether Respondents had knowledge of Rule 11-44 prior to commencing or while continuing the Mississippi Action. In re Rubin, 378 F.2d 104 (3d Cir. 1967). The bankruptcy court decided both questions in the affirmative, and the district court concurred.

The undisputed evidence in the bankruptcy court, including Respondents' own testimony, demonstrated their actual knowledge of both the pending Chapter XI case and the provisions of Rule 11-44 prior to the commencement of the Mississippi Action. (App. at 12.) At the hearing in the bankruptcy court, Respondent Goodale admitted having read an article which appeared in the Wall Street Journal, Southwest Edition, on January 31, 1975, which showed that "Fidelity Mortgage Investors was seeking bankruptcy" (the "Article").\* (App. at 45.) The Article,

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\* Document No. 32 in the Index to the Record on Appeal.



which was admitted into evidence as a court exhibit, appeared, in part, on page 1 of the Wall Street Journal, and, in part, on page 12. On page 1, the portion referred to by Respondents Hubbard (App. at 70) and Goodale (App. at 45, 53), the following appeared:

Fidelity Mortgage, a sizable real estate investment trust, filed for protection under Chapter 11 of the Bankruptcy Act. (Story on Page 12) [Emphasis added.]

On page 12 a full, detailed, two-column story\* appeared, announcing in the headline "Fidelity Mortgage Files for Chapter 11," and identifying FMI as being initially based in Jacksonville, Florida. As on page 1, the Article used the name "Fidelity Mortgage" or "Fidelity Mortgage Investors," not just "FMI." Certainly, the Article had significance to Respondent Goodale, who not only showed it to Respondent Hubbard (App. at 53), but who also read and "still ha[d] the paper" more than two months after its publication. (App. at 45.)

Likewise, the testimony of Respondent Hubbard conclusively demonstrated that he knew of the FMI Chapter XI case and the stay provision of Rule 11-44 at least five days prior to the commencement of the Mississippi Action. Hubbard admitted that, on or about March 20, 1975, he

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\* Document No. 32 in the Index to the Record on Appeal.



read the "Plea in Abatement"\* (App. at 126) filed by FMI in the action commenced in January of 1975 by Respondents Camelia Builders, Inc. ("Camelia") and Farnale, Inc. ("Farnale") against the debtor in the Circuit Court of Rankin County, Mississippi (the "State Court Action"). (App. at 24, 79, 80, 81.) FMI's "Plea in Abatement" expressly states that on January 30, 1975, FMI filed a Chapter XI petition in the United States District Court for the Southern District of New York and that "[u]nder Rule 11-44 ... the filing of such Chapter XI petition automatically stays the commencement or continuation of any court or other proceeding against" FMI. Respondent Hubbard also testified that he had read Rule 11-44, referred to in the "Plea in Abatement," prior to commencing the Mississippi Action. (App. at 82.)

Besides admitting that he had read the Article and the "Plea in Abatement," Respondent Hubbard testified that he had verified the pendency of the FMI Chapter XI case with a clerk of the bankruptcy court on March 24, 1975 (App. at 81), one day prior to the service on FMI of the complaint commencing the Mississippi Action (the "Complaint"). (App. at 107.) Respondent Hubbard never

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\* Indeed, Respondent Hubbard affixed a copy of the "Plea in Abatement" as Exhibit "G" to the complaint commencing the Mississippi Action.



attempted to contact FMI's Mississippi attorneys who had filed the "Plea in Abatement" and who were identified therein, or FMI itself. (App. at 81.) Rather, Hubbard decided to "try to hedge [his] bet" by commencing the Mississippi Action. (App. at 77.)

Respondents' continued denial of knowledge of the FMI Chapter XI case prior to filing the Complaint is incredible. In fact, Respondents' second prayer for relief in the Complaint sought the vacation of "The Order of the Bankruptcy Court of the Southern District of New York authorizing Fidelity to foreclose its lien ..." (App. at 111). Moreover, Respondents allege in paragraph 6(h) of the Complaint, which is signed by Respondent Hubbard (App. at 112), that in "January, 1975, Fidelity apparently filed Chapter XI proceedings ...." (App. at 109.) In view of such evidence, the bankruptcy judge, after hearing all the testimony and observing the demeanor of the witnesses, determined that Respondents knew of the Chapter XI case well before they commenced the Mississippi Action. (App. at 91, 98.)

Respondents rely on In re Cary, 10 F. 662 (S.D.N.Y. 1882), a criminal contempt case decided over 90 years prior to the effective date of the Chapter XI Rules, for the proposition that due notice of an injunction must be given in order to hold one in contempt for violation of the injunction. In Cary, the court correctly refused to adjudge individuals



in contempt where the wording of the injunction was ambiguous and doubt existed as to such individuals' knowledge of the existence of the injunction (10 F. at 629). No such doubt exists here. Notwithstanding Respondents' attempt to obscure Rule 11-44, the stay provisions contained therein are clear and unambiguous. The evidence adduced before the bankruptcy court and the basis for its Certificate are clear and uncontroverted: more than one-and-a-half months after learning of the FMI Chapter XI case and after receiving further notice in the "Plea of Abatement," Respondents knowingly and wilfully commenced the Mississippi Action in violation of Rule 11-44.

As Respondents state at page 17 of their brief, "knowledge" -- not notice -- "is an indispensable element of contempt ...." Based on the evidence adduced in this case, however, one can have no doubt -- nor ~~find any~~ error in the holding of the courts below -- that Respondents had both knowledge (from reading the Article) and notice (from reading the "Plea in Abatement") of the FMI Chapter XI case and the Rule 11-44 stay of suits.



#### IV

#### ADEQUATE RELIEF WAS AVAILABLE TO RESPONDENTS UNDER RULE 11-44

Respondents argue that Rule 11-44 is unconstitutional because it would deprive them of their right to possession of property without any remedy, mistakenly relying on Sniadach v. Family Finance Corp., 395 U.S. 337 (1969), Fuentes v. Shevin, 407 U.S. 67 (1972), and North Georgia Finishing, Inc. v. Di-Chem, Inc., 419 U.S. 601 (1975).

The automatic stay contained in Rule 11-44 does not deny Respondents any rights or leave them without remedies for any wrongs they believe FMI committed against them. Respondents could have applied to the bankruptcy court as early as January 31, 1975, when they first became aware that FMI filed a Chapter XI petition (App. at 45, 68-69), in order to obtain relief from the automatic stay or to pursue their claim in the bankruptcy court. Sections (d) and (e) of Rule 11-44 specifically provide for such relief. Section (d) gives priority to hearing applications for relief from the stay and places the burden of proof on the party seeking continuation of the stay of lien enforcement. Section (e) further permits ex parte relief from the stay if the claimant can demonstrate that "immediate and irreparable injury, loss or damage" would result before the opposing party could be heard. Respondents



chose not to pursue the available relief, but commenced the Mississippi Action, cavalierly disregarding Rule 11-44 and the bankruptcy court's order of February 28, 1976.

None of the cases cited by Respondents is applicable here. Sniadach, supra, involved a challenge to a Wisconsin prejudgment garnishment procedure under which the defendant's salary was withheld without notice and without a prior hearing as to the probable validity of the claim. The United States Supreme Court characterized the garnishment as "a taking which may impose tremendous hardships on wage earners with families to support." 395 U.S. at 353. Respondents have no such compelling argument here. On the contrary, Respondents had relief which was immediately available in the bankruptcy court, but chose to ignore it.

The Court in Fuentes, supra, similarly sought to protect individuals from state replevin laws which authorized summary seizure of goods on an ex parte application. The Court found that such a procedure violated the due process clause of the 14th Amendment because the "statutes serve no . . . important governmental or general public interest." 407 U.S. at 557. Congress and the Supreme Court, however, have determined that the bankruptcy court's injunctive powers do serve an import-



ant general public interest. Cont'l. Illinois Nat'l Bank & Trust Co. v. Chicago, Rock Island & Pacific Ry., 294 U.S. 648 (1935); Murphy, Restraint and Reimbursement: The Secured Creditor in Reorganization and Arrangement Proceedings, 30 Bus. Law. 15, 19-22 (1974). As the Court in Fuentes noted, the "prejudgment replevin provisions work a deprivation of property without due process of law insofar as they deny the right to a prior opportunity to be heard before chattels are taken from their possessor. Our holding, however, is a narrow one." 407 U.S. at 579. (Emphasis added.)

North Georgia Finishing, Inc. v. Di-Chem, Inc., supra, another non-bankruptcy case, involved an unconstitutional state prejudgment garnishment procedure, and is distinguishable on the same basis as Sniadach and Fuentes, supra.

Respondents, therefore, had adequate relief available under Rule 11-44(d)-(e). They were aware of the provisions contained in Rule 11-44. (App. at 82, 126.) Instead of pursuing the appropriate remedies, they commenced the Mississippi Action. Their own refusal to take the proper steps to obtain relief, is hardly a violation of their rights, as they contend. On the contrary, their actions constituted contempt of the bankruptcy court.



FMI'S DEED OF TRUST WAS PROPERTY OF  
THE DEBTOR OVER WHICH THE CHAPTER XI  
COURT HAD EXCLUSIVE JURISDICTION

In a transparent attempt at avoiding the consequences of their conduct, Respondents have tried to obscure the issues by raising, among other things, a baseless jurisdictional objection. Respondents ignore the unambiguous provisions of the Bankruptcy Act (the "Act") which set forth the extensive jurisdiction of the bankruptcy court. Section 311 of the Act, 11 U.S.C. § 711, provides that the bankruptcy court in a Chapter XI case has "exclusive jurisdiction of the debtor and its property, wherever located."

Respondents misconstrue several cases in an attempt to show that the bankruptcy court had no jurisdiction to stay them from commencing the Mississippi Action. They misread In re A. Roth Co., 125 F.2d 396 (7th Cir. 1942), (Respondents' Brief at 10, 22), which was not a contempt proceeding, but a lienholder's application to the bankruptcy court for leave to foreclose on a mortgage. The court in Roth specifically noted as follows:

It has long been the practice that when one desires to make the trustee a party to a foreclosure suit, to first obtain permission from the Bankruptcy Court.  
[125 F.2d at 397.]

Had the lienholder in Roth proceeded with the foreclosure action without seeking leave of the bankruptcy court, he would presumably have been in contempt. The lienholder



in Roth, however, unlike Respondents, did seek relief from the bankruptcy court's stay of lien enforcement before proceeding in another court. 125 F.2d 397-398. Although the court of appeals found the bankruptcy court's denial of leave to foreclose to be an abuse of discretion, the court never denied the necessity of applying to the bankruptcy court for leave to foreclose; in fact, the court confirmed its belief in that requirement. Id. at 397.

Similarly, Respondents have misread Town of Agawam v. Connors, 159 F.2d 360 (1st Cir. 1947), cert. denied, 330 U.S. 845 (1947), (Respondents' Brief at 10, 22), which was also not a contempt proceeding. In Agawam, an ordinary bankruptcy case under Chapters I-VII of the Act, it was held that the bankruptcy court could not interfere with a state court action when in rem jurisdiction had attached prior to the filing of the bankruptcy petition. 159 F.2d at 363-364. Such facts do not appear here. The Mississippi Action was commenced by Respondents after the filing of the Chapter XI petition.

Because Agawam was a bankruptcy case, and not a Chapter XI case, the bankruptcy court's jurisdiction was based on property in the actual or constructive possession of the debtor at the date of bankruptcy. See Ex Parte Baldwin, 291 U.S. 610, 615 (1934); Mussman & Riesenfeld, Jurisdiction



in Bankruptcy, 13 Law & Contemp. Prob. 88, 92, 98 (1948); MacLachlan, Bankruptcy 205 (1956). In the Chapter XI case here, the bankruptcy court had the much broader jurisdiction over FMI's property "wherever located," pursuant to Section 311 of the Act. In re Stockman Dev. Co., 447 F.2d 387, 390 (9th Cir. 1971); see, Slenderella Systems of Berkeley, Inc. v. Pacific T&T Co., 286 F.2d 488, 489-90 (2d Cir. 1961). Furthermore, the debtor in Agawam did not have the broad protection of Rule 11-44. The stay given the bankrupt in Agawam, based on Section 11a of the Act, merely provided it with protection against certain actions on unsecured debts, whereas Rule 11-44 provides FMI with an automatic stay of all suits against the debtor and its property, even if such property is not in its possession.

Any act to enforce the lien, such as commencement of foreclosure, seizure of the property subject to the lien, or an attempt to sell the property even though seized prior to the filing of the petition would be violation of the automatic stay. It matters not that foreclosure proceedings were instituted prior to the filing of the Chapter XI petition, for Rule 11-44 includes "continuation of any court proceeding to enforce any lien against the debtor's property" within the broad scope of the stay. [8 Collier, Bankruptcy ¶3.22, at 261 (14th rev. ed. 1974).]

Respondents' reliance on Mid-Jersey National Bank v. Fidelity Mortgage Investors, 518 F.2d 640 (3d Cir. 1975), is also mistaken. Mid-Jersey involved FMI's deposit of money with the court after entry of judgment against FMI and before FMI filed its Chapter



XI petition. No comparable fact situation exists here. In neither the Mississippi Action nor the State Court Action was a judgment rendered, and no money of FMI was deposited with the courts prior to the commencement of the FMI Chapter XI case. Rather, FMI deposited the sum of \$75,964.33 with the District Court for the Southern District of Mississippi after the FMI Chapter XI case was commenced.

Relying upon Brunn v. Wichser, 75 F.2d 25 (3d Cir. 1934), and In re Copper Canyon Mining Co., 156 F. Supp. 535 (D. Del. 1957), Respondents improperly assert that FMI's first deed of trust on real property, which secured a loan in the principal amount of \$1,600,000 is not "property" of the debtor,\* and that, therefore, the bankruptcy court had no jurisdictional basis\*\* on which to stay them from prosecuting the Mississippi Action. The authorities, however, conclusively demonstrate that the contrary is true.

Brunn, supra, decided by the Third Circuit in 1934, was contradicted by this court's decision in In re Prudence-Bonds

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\* In fact, FMI now has title to the property in question by virtue of a trustee's sale held on March 28, 1975.

\*\* Rule 11-44 is broadly worded so as to stay suits "against the debtor" or its "property," thereby suggesting that any suit against the debtor, regardless of whether the debtor has any property, will be stayed.



Corporation, 77 F.2d 328, 330 (2d Cir. 1935), cert. denied, 296 U.S. 584 (1935), which held that mortgages are property of the debtor and actions which affect them may be stayed.

The facts of Copper Canyon, supra, are distinguishable from the case on appeal. Copper Canyon was a Chapter X case in which the court, among other things, enjoined the holder of a first deed of trust from commencing foreclosure proceedings because the reorganization trustee held a third deed of trust on the subject property. The court noted that its power to enjoin lien enforcement was limited to those cases where the lien was on property of the debtor. On that basis, the court concluded that it was without jurisdiction to continue to restrain the foreclosure proceeding commenced by the holder of the first deed of trust, stating:

Such interest as Copper Canyon may have as a result of being a third mortgage lien is not sufficient to constitute "property" as that term is used in Sec. 516 (4) of Title II. [156 F. Supp. 537.]

Thus, the basis for the court's decision was not that a deed of trust or a mortgage per se is not property; rather, the court found that the third mortgage lien in question was not "sufficient" to constitute property. In this case, however, the property interest held by FMI was



represented by a first mortgage lien.<sup>\*</sup> Moreover, the rationale of Brunn and Copper Canyon is questionable in view of the more recent decisions of the United States Supreme Court in Segal v. Rochelle, 382 U.S. 375 (1966), and of the Fifth Circuit in In re Westec, 460 F. 2d 1139 (5th Cir. 1972).

In Segal v. Rochelle, the Court was required to determine whether a loss-carryback tax refund was property within the meaning of Section 70a(5) of the Act, 11 U.S.C. 110a(5), so that title thereto would vest in the trustee in bankruptcy. In discussing the general concept of property, Justice Harlan, for the Court, stated:

Admittedly, in interpreting Sec. 70a(5), "[i]t is impossible to give any categorical definition to the word 'property,' nor can we attach to it in certain relations the limitations which would be attached to it in others." [Citations omitted.] Whether an item is classified as "property" by the Fifth Amendment's Just-Compensation Clause or for purposes of a state taxing statute cannot decide hard cases under the Bankruptcy Act, whose own purposes must ultimately govern.

The main thrust of §70a(5) is to secure for creditors everything of value the bankrupt may possess in alienable or leviable form when he files his petition. To this end the term "property" has been construed most generously and an interest is not outside its reach because it is novel or contingent or because enjoyment must be postponed. [382 U.S. at 379.] [Emphasis added.]

<sup>\*</sup> As previously stated, the lien was converted to an absolute fee interest as the result of a non-judicial foreclosure sale on March 28, 1975.



Thus, FMI's first deed of trust, which represented a contingent interest in realty, comes within the definition of property under the Act. That proposition was recognized and affirmed by the Fifth Circuit Court of Appeals in In re Westec Corporation, 460 F.2d 1139 (5th Cir. 1972).

In Westec, a Chapter X case, the court was required to determine whether the bankruptcy court had jurisdiction to set aside a completed tax sale of certain property on which the trustee held first and second mortgages. The court noted that Sections 111 and 148 of the Act, 11 U.S.C. §§ 511, 548, not only give the court "exclusive control over all property of the debtor wherever located, but also establish an automatic stay without notice of any pending proceeding and the commencement of any further proceeding to enforce a lien against the debtor's property. . . ." 460 F.2d at 1142. Section 311 of the Act and Rule 11-44, applicable here, also give Chapter XI courts the same powers as those conferred by Sections 111 and 148 of the Act in Chapter X cases. See also, Rule 10-601 of the Rules of Bankruptcy Procedure.

The Westec court, relying in part upon Segal v. Rochelle, supra, concluded that a mortgage lien, even though subordinate to a statutory tax lien, was property



subject to the jurisdiction of the bankruptcy court,  
stating:

The Trustee here, at the time of the foreclosure, held the first and second mortgage on the real estate in question. Certainly, this interest constitutes "property" within the meaning of Sections 111 and 148 of the Bankruptcy Act, as "property" can constitute something other than fee ownership. [Citations omitted.] [460 F.2d at 1143.]

The court distinguished In re Copper Canyon Mining Co., supra, noting that the decision was predicated upon the "insignificance of the debtor's third mortgage, and not that the third mortgage did not constitute property." 460 F.2d at 1143.

Additionally, the Westec court, after stating that the debtor had not filed a copy of the restraining order in the public records of the appropriate county, found that the taxing authority had knowledge of the Chapter X case. 460 F.2d at 1141, 1143. The court then held that having knowledge -- notice not being necessary -- the taxing authority was required to seek a modification of the restraining order. "[T]he technicalities of state law simply cannot take precedence over the restraining order issued by the Chapter X court." 460 F.2d 1143.



Respondents do not contest FMI's first deed of trust, or that property of the debtor is within the jurisdiction of the bankruptcy court and the protection afforded by Rule 11-44. As the foregoing authorities conclusively demonstrate, FMI's first deed of trust was "property." Respondents also do not dispute that by commencing the Mississippi Action, they were attempting to subordinate FMI's first lien to their asserted mechanics' and materialmen's lien against the subject property, which now belongs to FMI. Accordingly, the bankruptcy court had jurisdiction to stay Respondents from enforcing their asserted lien\*.

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\* FMI does not concede the validity of the lien asserted by Respondents. Even if the lien were valid, however, that fact would have no bearing on the issue of Respondents' contempt.



VI

RESPONDENTS' RELIANCE UPON  
28 USC § 959 IS MISPLACED

A. FMI, As Debtor-in-Possession, Was Not "Conducting Business" Within the Meaning of 28 U.S.C. § 959.

Respondents self-servingly contend that their commencement of the Mississippi Action against FMI was authorized by 28 U.S.C. §959 because the action "is directed towards the manner in which FMI is carrying on business. . . ." (Respondents' Brief at 32.) The Complaint (App. at 108-126) demonstrates that Respondents Camelia and Farnale, doing business as a joint venture, sought an order from the Mississippi federal court (1) enjoining FMI from proceeding with the non-judicial foreclosure sale of certain property in Mississippi subject to its lien; (2) declaring their asserted mechanics' and materialmen's lien for services purportedly rendered prior to the commencement of the FMI Chapter XI case, in the amount of \$75,964.33, superior to FMI's lien; (3) modifying an order purportedly entered by the bankruptcy court in the Chapter XI case; and, if the foreclosure sale was not enjoined, (4) requiring FMI to turn over the proceeds from the sale of the subject property, to the extent of the sum of \$75,964.33. (App. at 111.)



In essence, Respondents now argue that FMI opened the door to a law suit against it when it commenced the non-judicial foreclosure sale, no matter how remote or peripheral such a suit might be.

28 U.S.C. § 959 provides in pertinent part as follows:

a. Trustees, receivers or managers of any property, including debtors-in-possession, may be sued, without leave of the court appointing them, with respect to any of their acts or transactions in carrying on business connected with such property. Such actions shall be subject to the general equity power of such court so far as the same may be necessary to the ends of justice, but this shall not deprive a litigant of his right to trial by jury. [Emphasis supplied.]

Section 959 was intended to create an exception to the general rule that law suits against receivers or trustees in bankruptcy could not be brought without leave of the court. Vass v. Conron Bros. Co., 59 F.2d 969, 970 (2d Cir. 1932). The intended exception was a narrow one, however, limited only to those actions against receivers, trustees or debtors-in-possession which are directly related to acts or transactions of such fiduciaries in their carrying on of the business connected with the property entrusted to them. See Austrian v. Williams, 216 F.2d 278 (2d Cir. 1954), cert. denied, 348 U.S. 953 (1955); Vass v. Conron Bros. Co., 59 F.2d



969 (2d Cir. 1932); In re American Associated Systems, Inc., 373 F.Supp. 977 (E.D. Ky. 1974); see also, 2 Collier, Bankruptcy ¶ 2.36 at 247-48 (14th rev. ed. 1975).

The allegations of the Complaint in the Mississippi Action do not in any way relate to or arise from an act of the debtor-in-possession in carrying on the business of the debtor. Rather, Respondents Camelia and Farnale were attempting to subordinate FMI's deed of trust and enforce a purported mechanic's lien on the subject property arising from work performed before the commencement of the Chapter XI case.

The foregoing is confirmed by the petition commencing the State Court Action, which was filed by Camelia and Farnale against the debtor prior to the date on which FMI filed its Chapter XI petition. (App. at 121-125.) FMI commenced preparations for non-judicial foreclosure prior to the commencement of the Chapter XI case. (App. at 25, 31-32.) In the State Court Action, as in the Mississippi Action, Camelia and Farnale sought (1) an order enforcing their purported mechanics' and materialmen's lien against the subject property; and (2) a monetary judgment against the debtor. (App. at 124.) The striking similarity in relief sought by Respondents in the State Court Action and in the Mississippi Action undermines their contention that the Mississippi Action relates to an "act or transaction" of FMI, as debtor-in-possession, which is required by



28 U.S.C. § 959. Thus, Respondents sought the same relief against FMI, debtor-in-possession, as they did against FMI, as debtor.

Assuming, arguendo, that the Mississippi Action relates to FMI's conduct as debtor-in-possession, the cases construing 28 U.S.C. § 959 nevertheless demonstrate that FMI's conduct does not come within the purview of the subject statute. The authority conferred by 28 U.S.C. § 959 permits third parties to hold a debtor-in-possession accountable for torts which it commits in the furtherance of its business operations. It was not meant to foster interference with the use, control, maintenance and operation of the debtor's property. See In re American Associated Systems, Inc., 373 F.Supp. 977, 979 (E.D. Ky. 1974); see also 2 Collier, Bankruptcy ¶ 2.36 at 248 (14th rev. ed. 1975). Respondents' belated allegation on this appeal that FMI committed a tort (Respondents' Brief at 33) is merely an afterthought, because this allegation was not raised in either the Mississippi Action or in the courts below. (App. at 108-112, 121-24.) Furthermore, when a trustee or debtor-in-possession\* does that which is necessary to maintain the assets of an estate for the benefit of its

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\* A debtor-in-possession has not only the "title and powers" of a trustee, but also the "rights, duties and remedies" of a trustee in bankruptcy. In re J. R. Cianchette & Sons Corp., 198 F.Supp. 740, 742 (D. Me. 1961); In re Martin Custom Tires Corp., 108 F.2d 172, 173 (2d Cir. 1939).



creditors, those acts cannot be grounds for the commencement of a plenary action under the 28 U.S.C. § 959 exception. See Austrian v. Williams, 216 F.2d 278 (2d Cir. 1954), cert. denied, 348 U.S. 953 (1955); Vass v. Conron Bros. Co., 59 F.2d 969 (2d Cir. 1932); In re American Associated Systems, Inc., 373 F.Supp. 977 (E.D. Ky. 1974); Melvin v. Klein, 266 N.Y.S. 2d 533 (Sup. Ct. 1965).

In Vass v. Conron Bros. Co., 59 F.2d 969 (2d Cir. 1932), the bankrupt had operated a cold meat storage plant and had leased to Conron Bros. Co. a portion of the premises which the bankrupt had agreed to refrigerate. After the trustee in bankruptcy affirmed the bankrupt's lease, Conron alleged that the trustee had failed to refrigerate the premises properly, causing the goods to spoil. Conron then commenced an action in the state court in reliance upon 28 U.S.C. § 125, the predecessor to Section 959, having mistakenly presumed that the trustee's assumption of the bankrupt's lease made him amenable to suit. This court rejected Conron's contention, however, and affirmed the bankruptcy court's order staying the prosecution of the state court action.

Holding that Conron's claim did not arise from an "act or transaction" of the trustee in carrying on the business of the bankrupt, this court set forth guidelines



for determining what action may be taken by a trustee without exposing himself to suits under 28 U.S.C. § 959:

To "carry on the business" is, we should think, the same thing as to "continue" it under Section 2(5) of the Bankruptcy Act, 11 USCA § 11(5); it must involve enough to require an order of court. [Citations omitted.] Merely to hold matters in statu quo; to mark time as it were; to do only what is necessary to hold the assets intact; such activities do not seem to us to be a continuance of the business. This was all that [the trustee] did. When he took over the refrigerating plant, he found a lessee in possession of a part of them, from which he could not eject it. His alternatives were to accept the reversion, cum onere, as he did, making himself liable on covenants; or to reject it, leaving the bankrupts reversioners pro tanto, and owners of a most inconvenient interest in a building otherwise his own. He did no more than avoid this absurd complication, which would surely have impeded the settlement of the estate, and the discharge of his duties. It seems plain that he was not carrying on business as [28 U.S.C. § 959] uses that term.... [59 F.2d at 971.]

Thus, a debtor-in-possession which merely holds "the assets intact" cannot be deemed to be continuing its business.

Here, FMI was also merely preserving the assets of the estate. FMI's borrower defaulted on a loan in excess of \$1,000,000, which was secured by a first deed of trust. In order to preserve its asset, FMI had no alternative but to proceed against the collateral by commencing the trustee's sale. Hence, the bankruptcy court properly



determined that for FMI to have done otherwise would have been to breach its fiduciary obligation as a debtor-in-possession to protect and preserve its assets for the benefit of the estate and its creditors, an obligation imposed upon a debtor-in-possession whether or not authorized to operate the business of the debtor. (App. at 5.) See generally Gardner-Denver Co. v. C. J. Haslam, Inc., 325 F.2d 208 (2d Cir. 1963); In re Roosevelt Lanes, Inc., 234 F.Supp. 842 (E.D.N.Y. 1964), aff'd per curiam, 342 F.2d 1000 (2d Cir. 1965); 8 Collier, Bankruptcy ¶ 6.32 at 928-29 (14th rev. ed. 1975).

Likewise, in Austrian v. Williams, 216 F.2d 278 (2d Cir. 1954), cert. denied, 348 U.S. 953 (1955), the court reaffirmed its holding in Vass, supra, that the collection and liquidation of assets is not "carrying on business" within the meaning of 28 U.S.C. § 959. In Austrian, the Chapter X reorganization trustees had commenced a plenary action in federal court against the debtor's former officers, directors and principal stockholders, charging them with various derelictions in their management of the debtor's affairs. A trial on the trustee's claim resulted in a dismissal, and the defendants thereafter asserted claims in the federal action against the trustees, alleging, inter alia, that by



commencing the plenary action the trustees forfeited their immunity from liability in any court where the controversy was heard. This court rejected the defendants' contentions, holding that the suit commenced by the trustees did not constitute "'carrying on the business of the debtor.'" 216 F.2d at 285. The court, through then Judge Harlan, cited Vass v. Conron Bros. Co., supra, stating: "Merely to attempt to collect and liquidate the assets of a debtor is not to carry on its business in any proper sense of the term." 216 F.2d at 285. Thus, FMI's foreclosure sale falls squarely within the holding of Austrian: both actions sought "to collect and liquidate the assets of [the] debtor" and did not constitute carrying on the debtor's business.\*

In a case strikingly similar to the case on appeal, the trustee in In re American Associated Systems, Inc., 373 F.Supp. 977 (E.D. Ky. 1974), sought to have certain persons adjudged in contempt because of their violation of a stay order entered in the pending bankruptcy case. The contemnors had commenced actions in the state court against the trustee in bankruptcy and the bank-

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\* As set forth in Exhibit "A" annexed to FMI's Chapter XI petition, the debtor was "engaged in mortgage lending for construction and development of real estate, and in ownership and the attendant operations of ownership of real property." (App. at 4.) Respondents' contention that FMI's foreclosure is "an act carrying on [its] business" (Respondents' Brief at 32) is as illogical as stating that a lessor of real property is in the business of dispossessing its tenants.



ruptcy judge, among others, subsequent to the dismissal of previous actions which had been commenced by the trustee for the collection of certain amounts due on promissory notes allegedly held by the contemnors and owed to the bankrupt. Because the trustee was unsuccessful in the litigation on the promissory notes, the contemnors alleged in their actions that the trustee and bankruptcy judge were guilty of libel, slander, malicious prosecution and conspiracy. In the contempt proceeding, the contemnors alleged that their malicious prosecution actions did not involve the "title, possession, or control of the res but a tort committed by the trustee in operating the debtor's business." 373 F.Supp. at 978.

The court rejected the contentions of the contemnors and adjudged them in contempt, reasoning that a trustee has an "official responsibility" to collect and reduce to money the property of the estate, and that this duty has nothing to do with the conduct of the bankrupt's business.

To this end, the trustee must institute necessary legal actions including those arising from contract..."Rights of action arising upon the contracts or property of the bankrupt, not yet resolved into suit, pass to the trustee and he should assert them in the proper tribunal whenever necessary for the collection or preservation of the bankrupt estate." [Citations omitted.] Thus, the commencement of suit in state court for



recovery of sums allegedly due the bankrupt was commanded by the statutory directive to liquidate the estate assets, and is not classifiable as "carrying on business" as contemplated by 28 U.S.C. 959(a). 373 F. Supp. at 978-79.

Here, the right of FMI, as debtor-in-possession, to foreclose arose from the deed of trust between the debtor and its borrower. Thus, the bankruptcy court determined that the commencement of the foreclosure by FMI was merely an enforcement of that right and, in foreclosing, FMI was fulfilling its obligation to protect and preserve its assets. (App. at 95.)

B. Respondents' Enforcement of a Lien on Property Does Not Come Within the Scope of Section 959.

A debtor's mortgage or lien is a property interest subject to the jurisdiction of the bankruptcy court. In re Westec Corp., 460 F.2d 1139 (5th Cir. 1972); In re Prudence-Bonds Corp., 77 F.2d 328, 330 (2d Cir. 1935). (See V, supra.) Respondents sought in the Mississippi Action to subordinate FMI's lien to their purported lien, and thus sought to enforce a lien on the property of FMI, as debtor-in-possession, property that was in custodia legis. Actions against property within the bankruptcy court's jurisdiction, however, are not permissible under 28 U.S.C. §959\*. See Field v. Kansas City Refining Co., 9 F.2d 213 (8th Cir.),

\* In fact, Rule 11-61(a)(2) expressly provides that a proceeding to "determine the validity, priority, or extent of a lien or other interest in property" is an "adversary proceeding" governed by "Part VII of the Bankruptcy Rules."



cert. denied, 271 U.S. 676 (1925); Field v. Kansas City Refining Co., 296 F.800 (8th Cir.), cert. denied, 266 U.S. 618 (1924); J.I. Case Plow Works v. Finks, 81 F.529 (5th Cir. 1897); In re American Associated Systems, Inc., 373 F.Supp. 977 (E.D. Ky. 1974); American Brake Shoe & Foundry Co. v. Interborough Rapid Transit Co., 10 F.Supp. 512 (S.D. N.Y.), aff'd per curiam, 76 F.2d 1002 (2d Cir.), cert. denied, 295 U.S. 760 (1935); Dickinson v. Willis, 239 F. 171 (S.D. Iowa 1916); Love v. Louisville & E.R. Co., 178 F. 507 (W.D. Ky. 1910).

In American Brake Shoe & Foundry Co. v. Interborough Rapid Transit Co., 10 F.Supp. 512 (S.D.N.Y.), aff'd per curiam, 76 F.2d 1002 (2d Cir.), cert. denied, 295 U.S. 760 (1935), the court held that the predecessor to 28 U.S.C. §959 did not contemplate the allowance of suits, such as the Mississippi Action, intended to establish liens or possessory rights in the res subject to the bankruptcy court's jurisdiction.

As uniformly interpreted by the courts, ... [the] sole purpose [of 28 U.S.C. §959] is to make federal receivers amenable to state court suits on causes of action arising out of the ordinary operation of the company in receivership. Actions for personal injuries caused by the negligent operation of a common carrier are a familiar example. Gableman v. Peoria, Decatur and Evansville R.R. Co., 179 U.S. 335, 21 S.Ct. 171, 45 L. Ed 220 (1900). On the other hand, causes directly affecting the administration of the receivership res, or



property rights therein, do not fall within the provision; to allow such suits to be instituted without leave of the court which has the property in its custody would divest it of its exclusive jurisdiction thereover and lead but to conflict and confusion in administration. Such was not the legislative purpose. [10 F.Supp. at 518.] [Emphasis supplied.]

None of the authorities cited by Respondents support their reliance on Section 959. In re Duke, 15 F.2d 92 (E.D. Mo. 1924), cited by Respondents even though it is not a Section 959 case, squarely confirms the inapplicability of Section 959. The receiver of the Duke Cap Company had applied to the court in order to obtain the greater compensation of a receiver who "conducts the business" of the debtor rather than that of an "ordinary" receiver. The court disagreed with the receiver's contention that his completion of caps already in the process of manufacture was conducting the business and held he was an "ordinary" receiver. Similarly, FMI, as debtor, was already in the process of the non-judicial foreclosure on the Mississippi property when the debtor-in-possession took over and merely completed the foreclosure action, which was, in any event, not an act "carrying on business connected with such property," as required by Section 959.

The remaining authorities relied on by Respondents are also inapposite. City of New York v. Patton, 390 F.Supp. 1001 (S.D.N.Y. 1975), sheds no light on the



issues on appeal since the trustees there were sued for their refusal to pay for their use and maintenance of a pier during the pendency of a railroad reorganization case. Likewise, in Diners Club, Inc. v. Bumb, 421 F.2d 396 (9th Cir. 1970), and Novo Enzyme Corp. v. Baker, 361 F.Supp. 337 (S.D.N.Y. 1973), the trustees were sued for breach of contracts which they had either entered into or assumed.

As the foregoing authorities demonstrate, FMI, as debtor-in-possession, had the duties and responsibilities of a trustee in marshalling the assets of the estate for the benefit of its creditors. Accordingly, FMI's non-judicial foreclosure in Mississippi was only a discharge of those responsibilities, and the district court properly held that:

- The non-judicial foreclosure sale by FMI of property in which both FMI and Respondents Camelia Builders, Inc. and Farnale, Inc., a joint-venture, claimed liens, did not constitute a "carrying on of business" as required by 28 U.S.C. § 959(a). [App. at 22.]

Respondents' distortion of 28 U.S.C. §959 is an attempt not only to stay FMI, as debtor-in-possession, from discharging its responsibilities, but also to force FMI in the Mississippi Action to turn over monies which are within the exclusive jurisdiction of the bankruptcy court. Such an erroneous and misplaced reliance on 28 U.S.C. §959 should not be a valid defense in a contempt proceeding. Thus, the district court found



(App. at 22) that Respondents' deliberate disobedience of Rule 11-44 could not be mitigated by their mistaken reliance on 28 U.S.C. § 959. (See I-B, supra.) Respondents cannot avoid the consequences of their contemptuous conduct, and the district court's decision, therefore, must be affirmed.



## VII

### RESPONDENT HUBBARD SHOULD NOT BE EXCUSED FROM THE CONSEQUENCES OF HIS ACT

Respondent Hubbard seeks to avoid being penalized for his contemptuous conduct by relying on his status as counsel to Camelia and Farnale. He cites In re Watts & Sachs, 190 U.S. 1 (1903). But the Watts case, a criminal contempt case, is distinguishable from this civil contempt case because the alleged contemnors there were sentenced to imprisonment. Here, FMI only sought an order directing Respondent Hubbard to discontinue the Mississippi Action, to restore to FMI those monies it was deprived of in the Mississippi Action, and to reimburse FMI for those costs which it was caused to incur as a result of his conduct.

Respondent Hubbard also relies on Maness v. Meyers, 419 U.S. 449 (1975), for the proposition that an attorney cannot be held in contempt of court as a result of advice he gave to his clients. Yet Hubbard conveniently fails to note that the holding in Maness was limited to advice by counsel that his client should assert his Fifth Amendment Constitutional privileges. As Chief Justice Burger stated:

A lawyer who counsels his client not to comply with a court order during trial would, first, subject his client to contempt, and in addition, if he persisted, the lawyer would be exposed to sanctions for obstructing the trial. [419 U.S. at 459-460.]



Hubbard's conduct undoubtedly interfered with and obstructed the bankruptcy court's administration of the debtor's estate. Specifically, Hubbard counselled his clients to violate the specific stay of Rule 11-44 rather than to seek a modification thereof under the prescribed procedure. It cannot be disputed that all of the Respondents, and Hubbard in particular, had actual knowledge of the Chapter XI case and the Rule 11-44 stay.

Although Respondent Hubbard now argues that the court cannot adjudge him guilty of contempt, the record reflects that Hubbard took the primary role in Respondents' actions:

Q. Mr. Hubbard, who made the decision to file the lawsuit in Jackson, Mississippi, on March 24, 1975?

A. I did.

Q. Did you discuss the filing of that lawsuit with Mr. Goodale or any representative of Farnale?

A. No, I did not. [App. at 76.]

Hubbard cannot claim immunity for himself on one hand, while on the other try to assume complete responsibility and thereby insulate the other Respondents from liability. The district court found Respondent Hubbard "equally in contempt with the clients he counseled," (App. at 23) and cited with approval the language of the bankruptcy court opinion:



"I think he played fast and loose  
with the Rules....

"This Court is loathe to certify  
an attorney for contempt but if an attorney  
will not recognize and honor the obligation  
to obey the automatic stay provisions of  
the Rules, how could a layman be expected  
to do so." [App. at 23.]



### VIII

#### THE DISTRICT COURT PROPERLY ASSESSED COSTS AGAINST RESPONDENTS

It is well settled that a contemnor may be required to compensate those injured by his improper conduct, and that such compensation includes the payment of attorneys' fees, as well as costs relating to the contemptuous conduct and the contempt proceedings. See, Lance v. Plummer, 353 F.2d 585, 592 (5th Cir. 1965), cert. den., 384 U.S. 929 (1966); In re American Associated Systems, Inc., 373 F.Supp. 977, 980 (E.D.Ky. 1974); Backo v. Local 281, United Bro. of Carpenters & Joiners, 308 F.Supp. 172, 179 (N.D.N.Y. 1969), aff'd 438 F.2d 176 (2d Cir. 1970), cert. den., 404 U.S. 858 (1971); Babee-Tenda Corp. v. Scharco Mfg. Co., 156 F.Supp. 582, 588-589 (S.D.N.Y. 1957); see also Alyeska Pipeline Service v. The Wilderness Society, 421 U.S. 240, 44 L.Ed. 2d 141, 95 S. Ct. 1612 (1975).

In Alyeska Pipeline Service Co. v. The Wilderness Society, supra, the United States Supreme Court noted that one of the exceptions to what is commonly referred to as the American rule that attorneys' fees are not recoverable in litigation is in the area of contempt. Justice White stated that "a court may assess attorney's fees for the 'wilful disobedience of a court order ... as part of the fine to be levied on the defendant.'" [Citations omitted.] 44 L.Ed. at 154.



In In re American Associated Systems, Inc.,  
supra, for example, where the contemnors had improperly  
commenced a state court proceeding against the trustee in  
bankruptcy and the bankruptcy judge, the court awarded to  
the trustee and the bankruptcy judge all attorneys' fees  
and disbursements relating to the state court action. 373  
F.Supp. at 980.

Likewise, in Babee-Tenda Corp. v. Scharco Mfg.  
Co., 156 F.Supp. 582 (S.D.N.Y. 1957), where the defendants  
violated a writ of injunction issued in a trademark in-  
fringement case, the court noted that the penalty to be  
imposed on the defendants was "the actual damages suffered  
by the opposing parties from failure to comply with the in-  
junction and their costs and expenses including counsel fees  
in investigating the violations and prosecuting the con-  
tempt." 156 F.Supp. at 587.

Respondents' improper and unlawful commence-  
ment of the Mississippi Action caused FMI to incur substan-  
tial costs and expenses both with respect to the Mississippi  
Action and this contempt proceeding, to the detriment of  
FMI's estate and its creditors. Thus, the district court  
properly required Respondents (a) to reimburse FMI for all  
of its actual costs, expenses, disbursement and attorneys'



fees incurred both in defending the Mississippi Action\* and in prosecuting this contempt proceeding, and (b) to take all action necessary to effect the return of the \$75,964.33 which the debtor-in-possession was required to deposit with the clerk of the court in the Mississippi Action.

\* Respondents' allegation that James Young, an attorney who represented FMI in the Mississippi Action, has a conflict of interest, is not worthy of reply. (Respondents' Brief at 44.) Respondents cite several irrelevant cases, but state no facts to support their allegations. Indeed, Respondents' allegation is scandalous and immaterial, and should be stricken under this court's Rule 28.



Conclusion

The judgment of the district court should be affirmed in all respects.

Respectfully submitted,  
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Michael L. Cook,  
Richard P. Krasnow,  
Philip H. Kaban,  
Of Counsel.



UNITED STATES COURT OF APPEALS  
FOR THE SECOND CIRCUIT

-----x

In re :  
FIDELITY MORTGAGE INVESTORS, :  
Debtor, :  
FIDELITY MORTGAGE INVESTORS, :  
Applicant-Appellee, : Docket No. 76-5007  
v. :  
CAMELIA BUILDERS, INC., E. J. :  
YELVERTON, JR., FARNALE, INC., :  
R. L. GOODALE, and JEFFREY H. :  
HUBBARD, :  
Respondents-Appellants. :  
-----x

AFFIDAVIT OF SERVICE BY CERTIFIED MAIL

STATE OF NEW YORK )  
COUNTY OF NEW YORK ) ss.:

JOSE R. DUCUSIN, being duly sworn, deposes and says:

1. I reside at 35 Rock Street, Apartment No. 46, Jersey City, New Jersey 07306, I am over 18 years of age and I am not a party to the within proceedings.

2. On May 3, 1976, I served the Brief of Appellee Fidelity Mortgage Investors upon Jeffrey H. Hubbard, Esq. 2297 Two Shell Plaza, Houston, Texas 77002, by certified mail return receipt requested, by enclosing two true copies of same in a postpaid wrapper, certified mail No. 770185 with return receipt affixed thereto, properly addressed to him at his address and depositing said wrapper in an official depository



under the exclusive care and custody of the United States  
Postal Service within the City of New York, New York.

Jose R. Ducusin  
Jose R. Ducusin

Sworn to before me this  
3rd day of May, 1976

Richard P. Krasnow  
Notary Public

RICHARD P. KRASNOW  
Notary Public, State of New York  
No. 31-9820679  
Qualified in New York County  
Commission Expires March 30, 1978



STATE OF NEW YORK, COUNTY OF

CERTIFICATION BY ATTORNEY

The undersigned attorney certifies that the within  
has been compared by the undersigned with the original and found to be a true and complete copy.

Dated: .....

STATE OF NEW YORK, COUNTY OF

ATTORNEY'S AFFIRMATION

The undersigned, an attorney admitted to practice in the courts of New York State, shows: that deponent is  
the attorney(s) of record for  
in the within action; that deponent has read the foregoing  
and knows the contents thereof; that the same is true to deponent's own knowledge, except as to the matters therein  
stated to be alleged on information and belief, and that as to those matters deponent believes it to be true. Deponent  
further says that the reason this verification is made by deponent and not by

The grounds of deponent's belief as to all matters not stated upon deponent's knowledge are as follows:

The undersigned affirms that the foregoing statements are true, under the penalties of perjury.

Dated: .....

STATE OF NEW YORK, COUNTY OF

ss.:

INDIVIDUAL VERIFICATION

deponent is                      the  
   read the foregoing  
the same is true to deponent's own knowledge, except as to the matters therein stated to be alleged on information and  
belief, and that as to those matters deponent believes it to be true.  
Sworn to before me, this                      day of                      19 .....

STATE OF NEW YORK, COUNTY OF

ss.:

CORPORATE VERIFICATION

   of                      , being duly sworn, deposes and says that deponent is the  
   the corporation  
named in the within action; that deponent has                      read the foregoing  
and knows the contents thereof; and that the same is true to deponent's own knowledge, except as to the matters therein  
stated to be alleged upon information and belief, and as to those matters deponent believes it to be true.  
This verification is made by deponent because  
is a                      corporation. Deponent is an officer thereof, to-wit, its  
The grounds of deponent's belief as to all matters not stated upon deponent's knowledge are as follows:

Sworn to before me, this

day of

19 .....







NOTICE OF ENTRY

Sir :—Please take notice that the within is a (certified) true copy of a duly entered in the office of the clerk of the within named court on 19

Dated,

Yours, etc.

WEIL, GOTSHAL & MANGES

Attorneys for

Office and Post Office Address

767 FIFTH AVENUE

Borough of Manhattan New York, N.Y. 10022

To

Attorney for

NOTICE OF SETTLEMENT

Sir :—Please take notice that

of which the within is a true copy will be presented for settlement to the Hon.

one of the judges of the within named Court, at

on the day of 19

at M.

Dated,

Yours, etc.

WEIL, GOTSHAL & MANGES

Attorneys for

Office and Post Office Address

767 FIFTH AVENUE

Borough of Manhattan New York, N.Y. 10022

To

Attorney for

Index No. 76-5007

Year 19

UNITED STATES COURT OF APPEALS  
FOR THE SECOND CIRCUIT

In re

FIDELITY MORTGAGE INVESTORS,  
Debtor,  
FIDELITY MORTGAGE INVESTORS,  
Applicant-Appellee,

v.

CAMELIA BUILDERS, INC., E. J.  
YELVERTON, JR., FARNALE, INC.,  
R. L. GOODALE, and JEFFREY H.  
HUBBARD,

Respondents-Appellants.

AFFIDAVIT OF SERVICE BY  
CERTIFIED MAIL

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767 FIFTH AVENUE

Borough of Manhattan New York, N.Y. 10022

(512) PLAZA 8-7800

To

Attorney for

Service of a certified copy of the within

is hereby admitted.

Dated,

Attorney for